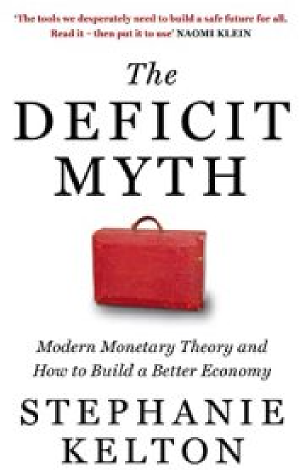
Book Review: The Deficit Myth: Modern Monetary Theory and the Birth of the People’s Economy by Stephanie Kelton

In **The Deficit Myth: Modern Monetary Theory and the Birth of the People’s Economy***,* **Stephanie Kelton** *dispels six key myths that have shaped the conventional understanding of deficits as inherently bad, instead arguing that deficits can strengthen economies and lead to faster growth. This book is a triumph, writes* **Hans G. Despain***, shifting normative grounds of government spending away from the false and unproductive idea that deficits are irresponsible and ruinous towards the productive political activity of deciding which spending programmes should be prioritised.*

The Deficit Myth: Modern Monetary Theory and the Birth of the People’s Economy**. Stephanie Kelton. PublicAffairs. 2020.**



Countries across the globe have shut down their economies in an effort to combat COVID-19. Massive increases in government spending have offered relief to households and businesses, but according to many politicians and economists, this government spending has generated ‘national debt dilemmas.’

The United States and the United Kingdom are projected to have public debt levels soar above 100 per cent of gross domestic product (GDP). Japan’s public debt to GDP ratio is expected to grow above 250 per cent. The IMF anticipates the average debt-to-GDP ratios in advanced economies will rise above 120 per cent.

With debt-to-GDP ratios so high, mainstream economists warn there will be a debt overhang post-pandemic, which they proclaim will force a curtailment of public spending in the future and an increase in taxes. The increased taxes will lower consumption spending of households and investment spending of businesses. The result is slower GDP growth and stagnation in worker’s wages and salaries.

Stephanie Kelton, in her new book *The Deficit Myth: Modern Monetary Theory and the Birth of the People’s Economy*, demonstrates that concerns about public debt overhang are ill-founded. Kelton argues that government spending properly targeted and government debt need not be problematic. Indeed, she argues that public deficits can be very healthy for an economy. Kelton contends bigger deficits can strengthen an economy and lead to faster growth.

However, the conventional wisdom regarding deficits is that they impede economic growth and weaken the economy. Conventional wisdom warns against using ‘deficits to solve problems [when] we continue to think of the deficit itself as a problem’ (8).

Currently the US national debt is more than $24 trillion, 106 per cent of GDP. However, $6 trillion of the national debt is held by government agencies such as the Social Security Trust Fund. If it seems strange the federal government can owe itself money, well indeed, federal debt is strange.

This strangeness is one of the reasons so many ‘myths’ cloud our understanding of public debt. Kelton identifies six primary myths of public debt. The first six chapters of her book dispel each primary myth. Chapters Seven and Eight explain how deficit can be used to generate a stronger economy with shared prosperity to reduce inequality and other social ills. In so doing, Kelton’s book achieves *two* groundbreaking triumphs and has one major ‘shortcoming’.

First, the shortcoming. Kelton's argument is based on modern monetary theory (MMT), which hinges on a critique of the orthodox view of money. The orthodox view of money asserts that the value of money is based historically on its link to precious metals and especially on its function as a medium of exchange. MMT contends the value of (modern) money derives from its link to credit (and debt) and underscores the important role the state plays regarding the ontology of money. George Knapp (1924) called this 'the state theory of money', J.M. Keynes further developed it in *The Treatise on Money* (1930), and it has been most recently promoted by L. Randall Wray (1998) and Warren Mosler (1993).

Kelton does not address the ontology of money of MMT. This can be seen as a shortcoming because it leaves a theoretical understanding of MMT undeveloped. However, my reading of Kelton has the shortcoming as a great strength, because it makes her argument far more accessible to a wider readership. Moreover, MMT's more esoteric theoretical and historical accounts of money are available elsewhere (e.g. Wray, 1998).

Kelton's groundbreaking triumphs are twofold. The first is that Kelton shatters both the deficit hawk and deficit dove view of public debt. Deficit hawks constitute the conventional wisdom on debt and contend the government is being irresponsible when it has a deficit, and therefore needs to balance its budget at almost any cost. Deficit hawks argue that public debt is ruinous to a currency and the country itself. Deficit hawks argue a country should tighten its purse strings and suffer short-term consequences to avoid long-term disaster. Deficit doves agree, but contend deficits can be used in the short term for emergencies and overcoming economic crises.

Kelton contends this leaves the debate stuck in the faulty idea that deficits are sinful. According to Kelton, we need to change our perspective and be wiser regarding deficits. Kelton calls herself a 'deficit owl' because owls have the ability to rotate their heads nearly 360 degrees for better perspectives and are associated with wisdom (76).

The conventional story contends governments levy taxes and then use them to pay for government spending. If government spending is greater than tax revenues, the government must borrow the rest by issuing bonds to investors (21-24). The conventional story contends government borrowing comes with huge snares. The increase in demand from loans increases interest rates. Government borrowing, via selling bonds, competes for the limited amount of savings so that private investment tends to fall, or gets 'crowded-out' (101-104), and GDP slows. Further, deficits make a country dependent on overseas investors (81-84).

Kelton contends the conventional story is a series of myths. To begin with, Kelton takes on the myth that governments should be fiscally run like a household (Chapter One). This is false because the government is nothing close to a household or private business. The big difference is that households and businesses are *users* of money, while governments are *issuers* of money (17 – 18).

Think of it this way: if you were granted the legal right and the ability to print as many US dollars as you wished, would that change your debt? The answer, of course, is yes. Your debt would no longer matter, because you can always just print more money.

Second, to view public deficits as overspending is a myth (Chapter Two), because a government deficit creates a *surplus* for someone else. The third myth is that deficits burden the next generation (Chapter Three). It is false that deficits make the next generation poorer, and it is also false that reducing deficits will make the next generation richer. Rather, the historical record shows high national debt creates wealth and increases the income of the next generation.

The fourth myth is that deficits crowd out private business (Chapter Four). Kelton argues that deficit spending properly targeted stimulates, or 'crowds-in', private business growth. The fifth myth is that deficits make us dependent on overseas nations (Chapter Five). Instead trade deficits should be understood as a 'stuff' surplus: e.g. China gets US Treasury bonds, and the US gets Apple computers and other 'stuff'. The sixth myth is that Social Security and public health programmes are propelling us toward a fiscal crisis (Chapter Six); here, Kelton shows the governments can always meet demographic and healthcare fiscal obligations.

The current surge in public expenditure given the sudden economic shutdown is quite telling and supports Kelton's argument. The government is self-financing: they do not necessarily need to collect taxes or borrow; they simply need to pay the dollars for the work activity they want accomplished. They cannot run out of money any more than a score keeper of a football game can run out of points. So long as a country is sovereign in its currency – that is, it issues and controls the supply of its currency (for instance, the UK and US governments) – it cannot run out of currency.

Government debt does matter, but we need to shift our understanding. Government debt is nothing like personal debt, because the federal government can issue more money. Nonetheless, it is not the imbalance between taxes collected and federal monies spent that matters. Rather what matters is the balance of real resources (257 – 260), to avoid generating bottlenecks, and the threat of inflation (44-47).

In the present moment, inflation is no threat whatsoever. The severe lack of consumption demand from households and investment demand from businesses makes deflation a greater worry than inflation. Once the economy begins to recover, policymakers will have to keep their eye on inflation. Nonetheless, for nearly 40 years, inflation has been well controlled. Partially this is due to international supply-chain competition and the business models of big corporations (Amazon, Wal-Mart, etc) that are built on low prices. There are several forces that will keep low inflation intact.

With no inflation and no bottlenecks, the government can address the true deficits (Chapter Seven), such as the good jobs deficit, the healthcare deficit, the education deficit, the infrastructure deficit, the green climate deficit and the democracy deficit, with no fiscal constraint. As such, Kelton contends the normative side of MMT should support building an economy that is geared toward people over profits and people over balanced budgets (Chapter Eight).

Kelton produces a dual shift in perspective. First, she demonstrates fiscal policy measures outdo monetary policy for steering, stabilising and managing the economy. Second, which specific fiscal policy measures are preferred are more a matter of politics and social preference than the science of economics. As Kelton states, the normative implications of her argument 'can be used to defend policies that are traditionally more liberal (e.g. Medicare for all, free college, or middle-class tax cuts) or more conservative (e.g. military spending or corporate tax cuts)' (235).

To be sure, the MMT tradition has promoted a job guarantee as the best fiscal buffer for the capitalist boom-bust cycle. Further, they have emphasised a guaranteed jobs programme should be built around public service and a 'care' economy. However, someone could fully agree with Kelton's economics and disagree with her suggested priority of fiscal measures.

Kelton's book achieves a revolution in political economy. Kelton's first great achievement leaves the conventional hawk/dove conception of deficits shattered. She decisively shows there is no budgetary constraint on government spending; instead the only real constraints on government spending are the limits of real resources and the threat of inflation. Kelton's second great achievement is to shift the normative grounds of government spending from the false and unproductive idea that federal deficits are evil, and to the productive political activity of deciding which spending programmes should be prioritised. Her Copernican achievements furthermore make esoteric debates on money accessible to a wide audience and wonky 'pie-in-the-sky' policy debates both comprehensible and *realistic*. The context of the current economic shutdown will place modern monetary theory and *The Deficit Myth* centre stage. Stephanie Kelton is the economist to carry this debate forward.

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About the author

Hans G. Despain – *Nichols College*
Hans G. Despain is a Professor of Political Economy at Nichols College.